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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF)
TUCSON ELECTRIC POWER COMPANY FOR)
APPROVAL OF ITS 2012 RENEWABLE)
ENERGY STANDARD IMPLEMENTATION)
PLAN AND DISTRIBUTED ENERGY)
ADMINISTRATIVE PLAN AND REQUEST FOR)
RESET OF RENEWABLE ENERGY ADJUSTOR)

DOCKET NO. E-01933A-11-0269

**TUCSON ELECTRIC POWER
COMPANY'S RESPONSE TO
AECC'S REQUEST FOR
REHEARING OF
DECISION NO. 72736**

Tucson Electric Power Company ("TEP" or the "Company"), through undersigned counsel, hereby responds to AECC's Request for Rehearing of Decision No. 72736 (January 13, 2012). AECC's asserted justifications for rehearing are not well founded in law or in fact and should be rejected by the Commission.

OVERVIEW

In Decision No. 72736 (hereinafter "Decision"), the Commission decided that it was in the public interest to provide \$3,000,000 in additional production-based incentive ("PBI") funding for non-residential distributed generation ("DG") projects beyond what TEP needed to comply with the REST Rules.¹ This \$3,000,000 PBI Legacy Cost budget is intended to smooth out a dip in incentive funding for non-residential DG projects and to "avoid an undue decline in industry activity with accompanying layoffs."² However, the increased DG results in *decreased* kWh sales by TEP. Therefore, the Decision also provided that TEP should be allowed to recover its lost fixed cost revenues associated with DG projects funded by the PBI Legacy Cost budget.

TEP believes the AECC has misconstrued the Decision in seeking rehearing. The Decision does not violate Arizona law or the 2008 TEP Rate Case Settlement approved in

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¹ Decision No. 72736 at page 22, lines 11-13.

² Decision No. 72736 at page 22, lines 13-15.

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Decision No. 70628 (December 1, 2008). It does not provide TEP additional revenue above and beyond the revenue requirement approved in Decision No. 70628. Further, it does not create a new adjustor mechanism. TEP submits that the Decision simply reflects a Commission policy to increase PBI funding for non-residential DG to fix a perceived problem in the REST Rules and to ensure this increased DG deployment does not result in an unconstitutional confiscatory impact on TEP.

DISCUSSION

A. The Decision Does Not Violate Arizona Law.

AECC offers three summary arguments as to why it believes the Decision violates Arizona law. None of its arguments support rehearing.

First, contrary to AECC's assertion, TEP will not be "effectively" increasing its base rates nor will TEP be receiving an "unauthorized rate increase" under the Decision. Regarding customer charges, all the Commission did in the Decision was to set TEP's 2012 REST surcharge at a level to recover the approved 2012 REST budget. It did not change either TEP's base rate or TEP's approved revenue requirement.

It was very clear from the Open Meeting discussions that the Commission desired to address an anomaly in the REST Rules that created a "dip" in the non-residential DG requirements.³ That "dip" could jeopardize significant portions of the DG industry in southern Arizona.⁴ Therefore, the Commission was willing to fund a short period of over-compliance of the non-residential DG portion of the REST Rules through the REST surcharge.

However, if the Commission was going to adopt "a mechanism under which the non-residential DG industry can continue installing DG beyond the amount TEP needs for strict compliance" with the REST,⁵ the Commission also needed to address the lost kWh sales (and corresponding lost revenues) resulting from over-compliance through that mechanism. If it did

³ Decision No. 72736 at page 22, lines 1-10.

⁴ Decision No. 72736 at page 22, lines 6-10.

⁵ Decision No. 72736 at page 22, line 11-13.

1 not do so, the Commission would be reducing (not increasing as alleged by AECC) the revenue
2 requirement approved for TEP in Decision No. 70628. That revenue requirement is what TEP is
3 legally entitled to in order to meet its fixed operating costs and to have an opportunity to earn its
4 authorized rate of return on its rate base. Reducing those revenues through the new mechanism
5 approved by the Commission in the Decision would be confiscatory and, therefore,
6 unconstitutional unless there was a way to recapture those lost revenues.

7 AECC's reliance on *Scates* is misplaced because it depends on a misinterpretation of the
8 Decision. In fact, the lost fixed-cost recovery mechanism eliminates a potential infirmity under
9 Arizona constitutional law, which requires that the "rates established by the Commission should
10 **meet the overall operating costs** of the utility and produce a reasonable rate of return." *Consol.*
11 *Water Utilities, Ltd. v. Arizona Corp. Comm'n*, 178 Ariz. 478, 482, 875 P.2d 137, 141 (Ct. App.
12 1993)(emphasis added)(quoting *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d
13 612, 615 (Ct. App.1978)); see also *Residential Util. Consumer Office v. Arizona Corp. Comm'n*,
14 199 Ariz. 588, 591, 20 P.3d 1169, 1172 (Ct. App. 2001); *Tucson Elec. Power Co. v. Arizona Corp.*
15 *Comm'n*, 132 Ariz. 240, 245, 645 P.2d 231, 236 (1982); see also *Consol. Water Utilities, Ltd.*,
16 *supra*; *Residential Util. Consumer Office, supra*; *Scates, supra*.⁶ The lost fixed cost recovery
17 under the Decision simply *maintains* TEP's ability to cover its fixed costs and an opportunity to
18 earn a reasonable return as provided in Decision No. 70628 and the 2008 Settlement Agreement in
19 light of the Commission's requirement for the Company to increase the non-residential DG
20 standard.

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23 ⁶ The United States Constitution imposes a similar requirement on the Commission. As the United States
Supreme Court explained:

24 [T]he Constitution protects utilities from being limited to a charge for their property
25 serving the public which is so "unjust" as to be confiscatory.... If the rate does not
26 afford sufficient compensation, the State has taken the use of utility property without
paying just compensation and so violated the Fifth and Fourteenth Amendments.

27 *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-08 (1989).

1 Second, AECC appears to assume that the lost fixed-cost revenues would be collected
2 through a new adjustor, which it asserts must be established in a rate proceeding. However, TEP
3 will recover its lost-fixed cost revenues from the PBI Legacy Cost budget of \$3,000,000.⁷ That
4 budget will be recovered through TEP's Commission-approved REST surcharge adjustor, which
5 was approved in connection with the 2008 Settlement Agreement (Section VIII). Therefore,
6 AECC's contention that a new adjustor would be created is incorrect.

7 Third, AECC incorrectly asserts that the REST Rules do not allow TEP to recover lost
8 fixed-cost revenues. In fact, A.A.C. R14-2-1808 expressly provides that the REST surcharge can
9 include the recovery of the "reasonable and prudent costs" of complying with the REST Rules.
10 The Rules do not limit what the Commission may consider a "reasonable and prudent" cost and
11 they certainly do not preclude recovery of lost-fixed cost revenues resulting from DG provided
12 under the Rules. The Commission is free to construe its own rules to include certain lost fixed
13 cost recovery as a reasonable and prudent cost arising from mandatory compliance with the Rules.

14 In sum, AECC has failed to identify any violation of Arizona law that would support
15 rehearing of the Decision.

16 **B. The Decision Does Not Violate the 2008 Settlement Agreement.**

17 AECC asserts that the recovery of lost revenues due to reduced kWh sales "represents a
18 rate increase" in violation of the 2008 Settlement Agreement. As discussed above, TEP will not
19 realize an increase in its revenue requirement and will not increase its base rates as a result of the
20 Decision.

21 In fact, the Decision is structured to ensure that the 2008 Settlement is *not* violated.
22 Without the lost fixed cost recovery, the Commission would violate the 2008 Settlement
23 Agreement by decreasing (not increasing as alleged by AECC) TEP's approved revenue
24 requirement.

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⁷ Decision No. 72736 at page 23, lines 21-23.

1 In sum, AECC has failed to identify a violation of the 2008 Settlement Agreement that
2 would support rehearing of the Decision.

3 **C. The Decision Is Not Contrary to Prior Commission Decisions and Policy.**

4 AECC asserts that the Decision is contrary to prior Commission decisions and policies.
5 However, the Decision addressed a *novel* circumstance: what should the Commission do to incent
6 or facilitate *over-compliance* with the Commission's REST Rules in order to avoid harming the
7 DG industry or the Company. The Commission decided what was appropriate policy for this
8 particular circumstance.

9 Further, TEP's previous REST order (Decision No. 72033) did not address this
10 circumstance of over-compliance. Rather, that Decision addressed recovery of lost fixed cost
11 revenues for simply meeting the REST standard. The Decision is not contrary to that decision.

12 Finally, AECC's argues that the Commission's Decoupling Policy requires that a
13 decoupling or other automatic adjustment mechanism must be set in a rate case. TEP disagrees
14 with AECC's interpretation of that Commission policy. However, as discussed above, the lost
15 fixed cost recovery is being funded through the REST surcharge adjustor, which was approved by
16 the Commission in TEP's most recent rate case.

17 In sum, no Commission decision or policy requires rehearing of the Decision.

18 **CONCLUSION**

19 The Commission should deny AECC's Request for Rehearing of Decision No. 72736.

20 RESPECTFULLY SUBMITTED this 19th day of March 2012.

21 TUCSON ELECTRIC POWER COMPANY

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